for purposes of this section as if it never had been issued in the event that either—

(A) The option lapses unexercised or is irrevocably forfeited by the holder thereof, or

(B) On the date the option was issued, there was no significant likelihood that such option would be exercised within the five-year period from the date of such issuance and a purpose for the issuance of the option was to cause an ownership change prior to January 1, 1987.

(9) *Examples.* The rules of this paragraph (m) may be illustrated by the following examples.

Example 1. (i) A owns all 100 outstanding shares of L stock. A sells 11 shares to B on January 1, 1986. The January 1, 1986 testing date is disregarded under paragraph (m)(3) of this section. A sells another 40 shares to B on January 1, 1988. B's second stock purchase is an owner shift that does not result in an ownership change. B's percentage ownership interest on the testing date (51 percent) is only 40 percentage points greater than the lowest percentage of L stock owned by B at any time during the testing period (11 percent on and after May 6, 1986).

(ii) The facts are the same as in (i). In addition A sells 20 shares of his L stock to C on July 1, 1990. C's stock purchase is an owner shift. Because B and C together have increased their respective ownership interests in L by 40 and 20 percentage points relative to their lowest percentage stock ownership interests in L at any time during the testing period, C's purchase causes an ownership change. The testing period for any subsequent ownership change begins on the first day following C's acquisition, July 2, 1990.

Example 2. (i) C has owned 100 percent of L since March 22, 1980. On October 13, 1986, P merges into L. As a result of the merger, 40 percent of L stock is acquired by A, the sole shareholder of P. The merger of P into L is both an equity structure shift and an owner shift. The transaction, however, is not an ownership change with respect to L, because A's percentage ownership interest has increased by only 40 percentage points. On August 22, 1987, B purchases 15 percent of the L stock from C. B's purchase constitutes an owner shift resulting in an ownership change that is subject to section 382 because the aggregate increases in percentage ownership by B and C (respectively 40 percent and 15 percent) is more than 50 percentage points.

(ii) The facts are the same as in (i), except that the plan of reorganization is adopted on October 13, 1986, and the merger is completed on July 22, 1987. The result is the same as in (i).

(iii) The facts are the same as in (ii), except that the reorganization is completed on August 22, 1987, and B's purchase of the L stock occurs one month earlier, on July 22, 1987. Assume that after the reorganization on August 22, 1987, A and B own 40 percent and 15 percent, respectively, of L stock. Although the merger occurred pursuant to a plan of reorganization adopted before 1987, L is subject to section 382 following the equity structure shift, because the merger would not have caused an ownership change if it had been completed in 1986 after the commencement of the L's testing period.

(iv) The facts are the same as in (ii), except that B's purchase occurs on June 7, 1986. Assume that immediately after the reorganization on August 22, 1987, A and B own 40 percent and 15 percent, respectively, of L stock. Since the reorganization pursuant to a plan adopted before 1987, taken together with the other shifts in the ownership of L's stock between May 5, 1986, and December 31, 1986, would have caused an ownership change, section 382 does not apply as a result of the merger. Since an ownership change occurs as a result of the merger, L's testing period for purposes of any subsequent ownership change begins on October 14, 1986.

(v) The facts are the same as in (iv), except that B makes an additional purchase from C of one percent of L's stock on February 14, 1987. The result is the same as in (iv). B's additional purchase, however, is taken into account for the purpose of determining whether there is a second ownership change with respect to L.

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EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.382–2T, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at *www.fdsys.gov*.

§ 1.382–3 Definitions and rules relating to a 5-percent shareholder.

(a) *Definitions*—(1) *Entity*—(i) *In general.* An entity is any corporation, estate, trust, association, company, partnership or similar organization. An entity includes a group of persons who have a formal or informal understanding among themselves to make a coordinated acquisition of stock. A principal element in determining if such an understanding exists is whether the investment decision of each member of a group is based upon the investment decision of one or more other members. However, the participation by creditors in formulating a plan for an insolvency workout or a reorganization in a title 11 or similar

case (whether as members of a creditors' committee or otherwise) and the receipt of stock by creditors in satisfaction of indebtedness pursuant to the workout or reorganization do not cause the creditors to be considered an entity.

(ii) *Examples.* The following examples illustrate the provisions of paragraph (a)(1)(i) of this section.

Example 1. (i) L corporation has 1,000 shares of common stock outstanding. For the three-year period ending on October 1, 1992, L's stock was owned by unrelated individuals, none of whom owned five percent or more of L. A group of 20 individuals who previously owned no stock (the ''Group'') agree among themselves to acquire more than 5 percent of L's stock. The Group is not a corporation, trust, association, partnership or company. On October 1, 1992, pursuant to their understanding, the members of the Group purchase 600 shares of L common stock from the old shareholders of L (a total of 60 percent of L stock), with each member purchasing 30 shares.

(ii) Before the members of the Group acquired L's stock on October 1, 1992, no individual or entity owned, directly or indirectly, five percent or more of the stock of L. As a result, all shareholders were aggregated into a public group and L was considered to be owned by a single 5-percent shareholder (''Public L'') in accordance with §1.382–2T (g)(1) and (j)(1).

(iii) Under paragraph (a)(1)(i) of this section, the members of the Group have a formal or informal understanding among themselves to make a coordinated acquisition of stock and, therefore, the Group is an entity. Thus, the acquisition of more than five percent of the stock of L on October 1, 1992, by members of the Group is not disregarded under §1.382–2T(e)(1)(ii). Because no member of the Group owns, directly or indirectly, five percent or more of the stock of L, §§1.382–2T (g)(1) and (j)(1) require that the members of the Group be aggregated into a separate public group, which will be presumed to consist of persons unrelated to the members of Public L. Because there is a shift of more than fifty percentage points in the ownership of L stock during the three-year testing period ending on October 1, 1992, an ownership change occurs on October 1, 1992, as a result of the Group's purchase of the 600 shares.

Example 2. (i) Prior to October 1, 1992, L's 1,000 shares of outstanding stock were owned by unrelated individuals, none of whom owned five percent or more of the stock of L. L's management is concerned that L may become subject to a takeover bid. In separate meetings, L's management meets with potential investors who own no stock and are friendly to management to convince them to acquire L's stock based on an understanding that L will assemble a group that in the aggregate will acquire more than 50 percent of L's stock. On October 1, 1992, 15 of these investors each purchase 4 percent of L's stock.

(ii) Under paragraph (a)(1)(i) of this section, the 15 investors (the ''Group'') are treated as an entity because the members of the Group purchase L stock pursuant to a formal or informal understanding among themselves to make a coordinated acquisition of stock. Sections 1.382–2T (g)(1) and (j)(1) require that on October 1, 1992, the Group be aggregated into a separate public group, which has increased its ownership of L stock by 60 percentage points over its lowest level of ownership in the three-year period ending on October 1, 1992. Accordingly, an ownership change occurs on that date.

Example 3. (i) Prior to October 1, 1992, L's 1,000 shares of outstanding stock were owned by unrelated individuals, none of whom owned five percent or more of the stock of L. On October 1, 1992, an investment advisor advises its clients that it believes L's stock is undervalued and recommends that they acquire L stock. Acting on the investment advisor's recommendation, 20 unrelated individuals purchase 6 percent of L's stock in aggregate, with each individual purchasing less than 5 percent. Each client's decision was not based upon the investment decisions made by one or more other clients.

(ii) Because there is no formal or informal understanding among the clients to make a coordinated acquisition of L stock, their purchase of stock is not made by an entity under paragraph (a)(1)(i) of this section. As a result, they remain part of the public group which owns L stock, and no owner shift results upon their purchase of L stock under §1.382–2T(e)(1)(ii).

(iii) The result in this example would be the same under paragraph (a)(3)(i) of this section if the only additional fact was that the investment advisor is also the underwriter (without regard to whether it is a firm commitment or best efforts underwriting) for a primary or secondary offering of L stock.

(iv) Assume that the facts are the same except that, instead of an investment advisor recommending that clients purchase L stock, the trustee of several trusts qualified under section 401(a) sponsored by unrelated corporations causes each trust to purchase the L stock. In this case, the result is the same, so long as the investment decision made on behalf of each trust was not based on the investment decision made on behalf of one or more of the other trusts.

(iii) *Effective date.* (A) *In general.* The second, third and fourth sentences of paragraph (a)(1)(i) of this section and *Examples 1, 2* and *3* of paragraph

(a)(1)(ii) of this section apply to testing dates (determined by applying such sentence and examples) on or after November 20, 1990, but with respect to any group of persons that pursuant to a formal or informal understanding among themselves makes a coordinated acquisition of stock before November 20, 1990, only if the group increases or decreases its ownership of stock of the loss corporation relative to its percentage ownership interest at the close of November 19, 1990, by five percentage points or more on or after November 20, 1990.

(B) *Special rule.* If pursuant to a formal or informal understanding among themselves a group consisting only of regulated investment companies under section 851, qualified trusts under section 401, common trust funds under section 584, or trusts or estates that are clients of a trust department of a bank under section 581, make a coordinated acquisition of stock before November 20, 1990, the second, third and fourth sentences of paragraph (a)(1)(i) of this section and *Examples 1, 2,* and *3* of paragraph (a)(1)(ii) of this section apply for testing dates (determined by applying such sentences and examples) on or after November 20, 1990, only if the group increases its ownership of stock of the loss corporation relative to its percentage ownership interest at the close of November 19, 1990, by five percentage points or more on or after November 20, 1990.

(C) *Example.* The following example illustrates the provisions of paragraph (a)(1)(iii) of this section.

Example. Prior to November 1, 1990, L, a loss, corporation, is owned entirely by 1,000 unrelated individuals, none of whom owns as much as 5 percent of the stock of L (''Public L''). On November 1, 1990, 15 individuals (the ''Group'') each acquired 3 percent, or 45 percent, in total, of L stock pursuant to an understanding among themselves to make a coordinated acquisition of stock. The Group is not a corporation, trust, association, partnership or company. On March 1, 1992, six members of the Group each purchased an additional one percent of L stock, or 6 percent, in total, pursuant to the understanding. Accordingly, the Group increased its ownership in L stock by 51 percentage points during the three-year testing period ending on March 1, 1992. As a result, an ownership change of L occurs on March 1, 1992.

(2) [Reserved]

(b)–(i) [Reserved]

(j) *Modification of the segregation rules of § 1.382–2T(j)(2)(iii) and (3).*—(1) *Introduction.* This paragraph (j) exempts, in whole or in part, certain transfers of stock from the segregation rules of §1.382–2T(j)(2)(iii) and (3). Terms and nomenclature used in this paragraph (j), and not otherwise defined herein, have the same meanings as in section 382 and the regulations issued under section 382.

(2) *Small issuance exception.*—(i) *In general.* Section 1.382–2T(j)(2)(iii)(B) does not apply to a small issuance (as defined in paragraph (j)(2)(ii) of this section), except to the extent that the total amount of stock issued in that issuance and all other small issuances previously made in the same taxable year (determined in each case on issuance) exceeds the small issuance limitation. This paragraph (j)(2) does not apply to an issuance of stock that, by itself, exceeds the small issuance limitation.

(ii) *Small issuance defined.* ''Small issuance'' means an issuance (other than an issuance described in paragraph (j)(6) of this section) by the loss corporation of an amount of stock not exceeding the small issuance limitation. For purposes of this paragraph (j)(2)(ii), all stock issued in the issuance is taken into account, including stock owned immediately after the issuance by a 5-percent shareholder that is not a direct public group.

(iii) *Small issuance limitation.*—(A) *In general.* For each taxable year, the loss corporation may, at its option, apply this paragraph (j)(2)—

(*1*) On a corporation-wide basis, in which case the small issuance limitation is 10 percent of the total value of the loss corporation's stock outstanding at the beginning of the taxable year (excluding the value of stock described in section 1504(a)(4)); or

(*2*) On a class-by-class basis, in which case the small issuance limitation is 10 percent of the number of shares of the class outstanding at the beginning of the taxable year.

(B) *Class of stock defined.* For purposes of this paragraph (j)(2)(iii), a class of stock includes all stock with the same material terms.

(C) *Adjustments for stock splits and similar transactions.* Appropriate adjustments to the number of shares of a class outstanding at the beginning of a taxable year must be made to take into account any stock split, reverse stock split, stock dividend to which section 305(a) applies, recapitalization, or similar transaction occurring during the taxable year.

(D) *Exception.* The loss corporation may not apply this paragraph (j)(2)(iii) on a class-by-class basis if, during the taxable year, more than one class of stock is issued in a single issuance (or in two or more issuances that are treated as a single issuance under paragraph (j)(8)(ii) of this section).

(iv) *Short taxable years.* In the case of a taxable year that is less than 365 days, the small issuance limitation is reduced by multiplying it by a fraction, the numerator of which is the number of days in the taxable year, and the denominator of which is 365.

(3) *Other issuances of stock for cash*—(i) *In general.* If the loss corporation issues stock solely for cash, §1.382–2T(j)(2)(iii)(B) does not apply to such stock in an amount equal (as a percentage of the total stock issued) to one-half of the aggregate percentage ownership interest of direct public groups immediately before the issuance.

(ii) *Solely for cash*—(A) *In general.* A share of stock is not issued solely for cash if—

(*1*) The acquiror, as a condition of acquiring that share for cash, is required to purchase other stock for consideration other than cash; or

(*2*) The share is acquired upon the exercise of an option that was not issued solely for cash or was not distributed with respect to stock.

(B) *Related issuances.* Paragraph (j)(8)(i) of this section (relating to the treatment of one or more issuances as a single issuance) does not apply in determining whether stock is issued solely for cash.

(iii) *Coordination with paragraph (j)(2) of this section.* This paragraph (j)(3) does not apply to a small issuance exempted in whole from §1.382–2T(j)(2)(iii)(B) under paragraph (j)(2) of this section. In the case of a small issuance exempted in part from §1.382–2T(j)(2)(iii)(B) under paragraph (j)(2) of this section, this paragraph (j)(3) applies only to the portion of the issuance not so exempted, and that portion is treated as a separate issuance for purposes of this paragraph (j)(3).

(4) *Limitation on exempted stock.* The total amount of stock that is exempted from the application of §1.382–2T(j)(2)(iii)(B) under paragraphs (j)(2) and (j)(3) of this section cannot exceed the total amount of stock issued in the issuance less the amount of that stock owned by a 5-percent shareholder (other than a direct public group) immediately after the issuance. Except to the extent that the loss corporation has actual knowledge to the contrary, any increase in the amount of the loss corporation's stock owned by a 5-percent shareholder on the day of the issuance is considered to be attributable to an acquisition of stock in the issuance.

(5) *Proportionate acquisition of exempted stock*—(i) *In general.* Each direct public group that exists immediately before an issuance to which paragraph (j)(2) or (j)(3) of this section applies is treated as acquiring its proportionate share of the amount of stock exempted from the application of §1.382–2T(j)(2)(iii)(B) under paragraph (j)(2) or (j)(3) of this section.

(ii) *Actual knowledge of greater overlapping ownership.* Under the last sentence of §1.382–2T(k)(2), the loss corporation may treat direct public groups existing immediately before an issuance to which paragraph (j)(2) or (j)(3) of this section applies as acquiring in the aggregate more stock than the amount determined under paragraph (j)(5)(i) of this section, but only if the loss corporation actually knows that the aggregate amount acquired by those groups in the issuance exceeds the amount so determined.

(6) *Exception for equity structure shifts.* This paragraph (j) does not apply to any issuance of stock in an equity structure shift, except that paragraph (j)(2) of this section applies (if its requirements are met) to the issuance of stock in a recapitalization under section 368(a)(1)(E).

(7) *Transitory ownership by underwriter disregarded.* For purposes of §1.382–2T(g)(1) and (j), and this paragraph (j), the transitory ownership of stock by an

underwriter of the issuance is disregarded.

(8) *Certain related issuances.* For purposes of this paragraph (j), two or more issuances (including issuances of stock by first tier or higher tier entities) are treated as a single issuance if—

(i) The issuances occur at approximately the same time pursuant to the same plan or arrangement; or

(ii) A principal purpose of issuing the stock in separate issuances rather than in a single issuance is to minimize or avoid an owner shift under the rules of this paragraph (j).

(9) *Application to options.* The principles of this paragraph (j) apply for purposes of applying §1.382–2T(j)(2)(iii)(D) (relating to the deemed acquisition of stock as a result of the ownership of an option).

(10) *Issuance of stock pursuant to the exercise of certain options.* If stock is issued on the exercise of a transferable option issued by the loss corporation, §1.382–2T(j)(2)(iii)(F) does not apply and, in applying the last sentence of §1.382–2T(k)(2), the loss corporation must take into account any transfers of the option (including transfers described in §1.382–2T(h)(4)(xi)). Therefore, even if transferable options are distributed pro rata to members of existing public groups, the actual knowledge exception of §1.382–2T(k)(2) applies only to the extent that the loss corporation actually knows that the persons acquiring stock on exercise of the options are members of a pre-existing public group. Moreover, if transferable options are issued to more than one public group, §1.382–2T(j)(2)(iii)(F) does not apply to treat the options as exercised pro rata by each such public group as the options are actually exercised.

(11) *Application to first tier and higher tier entities*—(i) *In general.* The principles of paragraphs (j)(1) through (10) and paragraph (j)(12) apply to issuances of stock by a first tier entity or a higher tier entity that owns 5 percent or more of the loss corporation's stock (determined without regard to §1.382–2T(h)(2)(1)(A)).

(ii) *Small issuance limitation.* In applying paragraph (j)(2) of this section to any issuance of stock by a first tier or higher tier entity, the small issuance limitations of paragraph (j)(2)(iii)(A) and (B) of this section are computed by reference to the stock value and the stock classes of the issuing corporation.

(12) *Certain non-stock ownership interests.* As the context may require, a non-stock ownership interest in an entity other than a corporation is treated as stock for purposes of this paragraph (j).

(13) *Secondary transfer exception.* The segregation rules of §1.382–2T(j)(3)(i) will not apply to the transfer of a direct ownership interest in the loss corporation by a first tier entity or an individual that owns five percent or more of the loss corporation to public shareholders. Instead, each public group existing at the time of the transfer will be treated under §1.382–2T(j)(3)(i) as acquiring its proportionate share of the stock exempted from the application of §1.382–2T(j)(3)(i). The segregation rules also will not apply if an ownership interest in an entity that owns five percent or more of the loss corporation (determined without regard to the application of §1.382–2T(h)(2)(i)(A)) is transferred to a public owner or a 5-percent owner who is not a 5-percent shareholder of the loss corporation. Instead, provided that the transferor is either a 5-percent owner that is a 5-percent shareholder of the loss corporation or a higher tier entity owning five percent or more of the loss corporation (determined without regard to the application of section 1.382–2T(h)(2)(i)(A)), each public group of the entity existing at the time of the transfer is treated under §1.382–2T(j)(3)(i) as acquiring its proportionate share of the transferred ownership interest. With regard to a transferor that is neither a 5-percent shareholder of the loss corporation nor a higher tier entity owning five percent or more of the loss corporation (determined without regard to the application of §1.382–2T(h)(2)(i)(A)), see generally §1.382–2T(e)(1)(ii) (disregarding these transactions if the transferee is not a 5-percent shareholder).

(14) *Small redemption exception*—(i) *In general.* Section 1.382–2T(j)(2)(iii)(C) does not apply to a small redemption (as defined in paragraph (j)(14)(ii) of this section), except to the extent that the total amount of stock redeemed in

that redemption and all other small redemptions previously made in the same taxable year (determined in each case on redemption) exceeds the small redemption limitation. This paragraph (j)(14) does not apply to a redemption of stock that, by itself, exceeds the small redemption limitation.

(ii) *Small redemption defined. Small redemption* means a redemption of public shareholders by the loss corporation of an amount of stock not exceeding the small redemption limitation.

(iii) *Small redemption limitation*—(A) *In general.* For each taxable year, the loss corporation may, at its option, apply this paragraph (j)(14)—

(*1*) On a corporation-wide basis, in which case the small redemption limitation is 10 percent of the total value of the loss corporation's stock outstanding at the beginning of the taxable year (excluding the value of stock described in section 1504(a)(4)); or

(*2*) On a class-by-class basis, in which case the small redemption limitation is 10 percent of the number of shares of the class redeemed that are outstanding at the beginning of the taxable year.

(B) *Class of stock defined.* For purposes of this paragraph (j)(14)(iii), a class of stock includes all stock with the same material terms.

(C) *Adjustments for stock splits and similar transactions.* Appropriate adjustments to the number of shares of a class outstanding at the beginning of a taxable year must be made to take into account any stock split, reverse stock split, stock dividend to which section 305(a) applies, recapitalization, or similar transaction occurring during the taxable year.

(D) *Exception.* The loss corporation may not apply this paragraph (j)(14)(iii) on a class-by-class basis if, during the taxable year, more than one class of stock is redeemed in a single redemption (or in two or more redemptions that are treated as a single redemption under paragraph (j)(14)(v) of this section).

(E) *Short taxable years.* In the case of a taxable year that is less than 365 days, the small redemption limitation is reduced by multiplying it by a fraction, the numerator of which is the number of days in the taxable year, and the denominator of which is 365.

(iv) *Proportionate redemption of exempted stock*—(A) *In general.* Each direct public group that exists immediately before a redemption to which this paragraph (j)(14) applies is treated as having been redeemed of its proportionate share of the amount of stock exempted from the application of §1.382–2T(j)(2)(iii)(C) under this paragraph (j)(14).

(B) *Actual knowledge of greater redemption.* Under the last sentence of §1.382–2T(k)(2), the loss corporation may treat direct public groups existing immediately before a redemption to which this paragraph (j)(14) applies as having been redeemed of more stock than the amount determined under paragraph (j)(14)(iv)(A) of this section, but only if the loss corporation actually knows that the amount redeemed from those groups in the redemption exceeds the amount so determined.

(v) *Certain related redemptions.* For purposes of this paragraph (j)(14), two or more redemptions (including redemptions of stock by first tier or higher tier entities) are treated as a single redemption if—

(A) The redemptions occur at approximately the same time pursuant to the same plan or arrangement; or

(B) A principal purpose of redeeming the stock in separate redemptions rather than in a single redemption is to minimize or avoid an owner shift under the rules of this paragraph (j)(14).

(vi) *Certain non-stock ownership interests.* As the context may require, a nonstock ownership interest in an entity other than a corporation is treated as stock for purposes of this paragraph (j)(14).

(vii) *Application to first tier and higher tier entities*—(A) *In general.* The principles of this paragraph (j)(14) apply to redemptions of stock by a first tier entity or a higher tier entity that owns 5 percent of the loss corporation stock (determined without regard to §1.382–2T(h)(2)(i)(A)).

(B) *Small redemption limitation.* In applying this paragraph (j)(14) to any redemption of stock by a first tier or a higher tier entity, the small redemption limitations of paragraph

(j)(14)(iii)(A) of this section are computed by reference to the stock value and the stock classes of the redeeming corporation.

(15) *Exception for first tier and higher tier entities*—(i) *In general.* The segregation rules of §1.382–2T(j)(3)(iii) will not apply to a transaction involving stock in a first tier or a higher tier entity if, after taking into account the results of such transaction and all other transactions occurring on that date, the first tier or higher tier entity owns 10 percent or less (by value) of all the outstanding stock (without regard to §1.382–2(a)(3)) of the loss corporation.

(ii) *Anti-avoidance rule.* The rules of paragraph (j)(15)(i) of this section do not apply to a transaction involving an ownership interest in a first tier or higher tier entity if the loss corporation, directly or through one or more persons, has participated in planning or structuring the transaction with a view to avoiding the application of the segregation rules. For this purpose, a transaction includes any event that would result in segregation under §1.382–2T(j)(3)(iii), absent the application of this paragraph (j)(15), and any event (for example, the formation of a holding company) occurring as part of the same plan that includes the event that would result in segregation (without the application of this paragraph (j)(15)). Other anti-avoidance rules continue to be applicable. See, for example, §§1.382–2T(k)(4) and 1.382–3(a)(1).

(iii) *Special rules.* If application of paragraph (j)(15)(i) of this section results in the combination of public groups, then—

(A) The amount of increase in the percentage of stock ownership of the continuing public group will be the sum of its increase and a proportionate amount of any increase by any public group that is combined with the continuing public group (the former public group); and

(B) The continuing public group's lowest percentage ownership will be the sum of its lowest percentage ownership and a proportionate amount of the former public group's lowest percentage ownership.

(iv) *Ownership of the loss corporation.* In making the determination under paragraph (j)(15)(i) of this section—

(A) The rules of §1.382–2T(h)(2) will not apply;

(B) The entity will be treated as owning the loss corporation stock that it actually owns, and any other loss corporation stock if that other stock would be attributed to the entity under section 318(a) (without regard to paragraph (4) thereof) unless an option is treated as exercised under §1.382–4(d)); and

(C) The operating rules of paragraph (j)(15)(v) of this section will apply.

(v) *Operating rules.* Subject to the principles of §1.382–2T(k)(4), a loss corporation may establish the ownership limitation of paragraph (j)(15)(i) of this section through either—

(A) Actual knowledge; or

(B) Absent actual knowledge to the contrary, the presumptions regarding stock ownership in §1.382–2T(k)(1).

(16) *Examples.* The provisions of this paragraph (j) are illustrated by the following examples:

Example 1. (i) L corporation is a calendar year taxpayer. On January 1, 1994, L has 1,000 shares of a single class of common stock outstanding, all of which are owned by a single direct public group (Public L). On February 1, 1994, L issues to employees as compensation 60 new common shares of the same class. On May 1, 1994, L issues 50 new common shares of the same class solely for cash. Following each issuance, L's stock is owned entirely by public shareholders. No other changes in the ownership of L's stock occur prior to May 1, 1994. L chooses to determine its small issuance limitation for 1994 on a class-by-class basis under paragraph (j)(2)(iii)(A)(*2*) of this section.

(ii) The February issuance is a small issuance because the number of shares issued (60) does not exceed 100, the small issuance limitation (10 percent of the number of common shares outstanding on January 1, 1994). Under paragraph (j)(2) of this section, the segregation rules of §1.382–2T(j)(2)(iii)(B) do not apply to the February issuance. Under paragraph (j)(5) of this section, Public L is treated as acquiring all 60 shares issued.

(iii) The May issuance is a small issuance because the number of shares issued (50) does not exceed 100, the small issuance limitation (10 percent of the number of common shares outstanding on January 1, 1994). However, under paragraph (j)(2) of this section, only 40 of the 50 shares issued are exempted from the segregation rules of §1.382–2T(j)(2)(iii)(B) because the total number of shares of common stock issued in the February and May issuances exceeds 100, the small issuance limitation, by 10. Because the May issuance

is solely for cash, paragraph (j)(3) of this section exempts 5 of the 10 remaining shares from the segregation rules of §1.382–2T(j)(2)(iii)(B) (10 shares multiplied by 50 percent, one-half of Public L's 100 percent ownership interest immediately before the May issuance—1,060 shares/1,060 shares). Accordingly, under paragraph (j)(5) of this section, Public L is treated as acquiring 45 shares in the May issuance. Section 1.382–2T(j)(2)(iii)(B) applies to the remaining 5 shares issued, which are treated as acquired by a direct public group separate from Public L. Each such public group is treated as an individual who is a separate 5-percent shareholder. See §1.382–2T (g)(1)(iv) and (j)(1)(ii).

(iv) Assume that L actually knows that at least 10 shares of the May issuance are acquired by members of Public L. The result is the same. See paragraph (j)(5)(ii) of this section.

(v) Assume instead that L actually knows that all 50 shares of the May issuance are acquired by members of Public L. Under paragraph (j)(5)(ii) of this section, L may treat Public L as acquiring 50 shares in the May issuance.

Example 2. (i) L corporation is a calendar year taxpayer. On January 1, 1995, L has 1,000 shares of Class A common stock outstanding, the aggregate value of which is $1,000. Five hundred shares are owned by one direct public group (Public 1), and 500 shares are owned by another direct public group (Public 2). On August 1, 1995, L issues 200 shares of Class B common stock for $200 cash. A, an individual, acquires 120 Class B shares in the transaction. The remaining 80 Class B shares are acquired by public shareholders. No other changes in ownership of L's stock occur prior to August 1, 1995.

(ii) The August issuance is not a small issuance. The total value of the Class B stock issued ($200) exceeds $100, the small issuance limitation as calculated under paragraph (j)(2)(iii)(A)(*1*) of this section (10 percent of the value of L's stock on January 1, 1995). The total number of Class B shares issued (200) exceeds 0, the small issuance limitation as calculated under paragraph (j)(2)(iii)(A)(*2*) of this section (10 percent of the number of Class B shares outstanding on January 1, 1995). Accordingly, paragraph (j)(2) of this section does not apply to the August issuance.

(iii) Paragraph (j)(3) of this section, as limited by paragraph (j)(4) of this section, exempts 80 Class B shares from the segregation rule of §1.382–2T(j)(2)(iii)(B). Paragraph (j)(3) of this section, without regard to paragraph (j)(4) of this section, would exempt 100 Class B shares: the product of the 200 Class B shares issued and 50 percent (one-half of the combined 100 percent pre-issuance ownership interest of Public 1 and Public 2). Paragraph (j)(4), however, limits the total number of Class B shares that may be excluded to 80 Class B shares: the difference between the 200 shares issued and the 120 shares acquired by A. Under paragraph (j)(5) of this section, Public 1 and Public 2 are treated as acquiring the 80 exempted Class B shares. Because Public 1 and Public 2 each owned 500 Class A shares prior to the issuance, Public 1 and Public 2 are considered to acquire 40 Class B shares each.

Example 3. (i) L has 1,000 shares of a single class of common stock outstanding, all of which are owned by a direct public group (Public L). At the same time pursuant to the same plan, L issues 500 shares of its stock to its creditors in exchange for its outstanding debt and 500 shares of its stock to the public for cash. Assume that the separate issuances of stock for debt and stock for cash do not have a principal purpose of minimizing or avoiding an owner shift. L has no individual 5-percent shareholders immediately after the issuances.

(ii) The 500 shares of stock issued by L to its former creditors were not issued solely for cash. Therefore, paragraph (j)(3) of this section does not apply to those 500 shares, which are treated as owned by a public group separate from Public L. See §1.382–2T(j)(2)(iii)(B)(*1*)(*ii*).

(iii) Paragraph (j)(3) of this section applies to the 500 shares of stock issued by L to the public because that stock was issued solely for cash. Because the two issuances occur at the same time pursuant to the same plan, they are generally treated as a single issuance for purposes of this paragraph (j). See paragraph (j)(8)(i) of this section. The treatment of the two issuances as a single issuance does not apply, however, for the purpose of determining whether the stock issued to the public was issued solely for cash. See paragraph (j)(3)(ii)(B) of this section.

(iv) Paragraph (j)(3) of this section applies to exempt 250 of the 500 shares issued solely for cash from the segregation rules of §1.382–2T(j)(2)(iii)(B) (the product of the 500 shares issued for cash and 50 percent (one-half of the 100 percent pre-issuance ownership interest of Public L)). The creditors that receive stock in exchange for their debt would not be treated as acquiring any of the 250 exempted shares even if their exchange of debt for stock occurs prior to the cash issuance. Paragraph (j)(5)(i) of this section allocates exempted shares among the direct public groups that exist immediately before an issuance. Because the issuance for cash and the issuance for debt are generally treated as a single issuance, the public group comprised of the former creditors of L was not a public group that existed immediately before the issuance.

(v) Three public groups owning L stock exist immediately after the two issuances. Public L owns 1,250 shares—the 1,000 shares it owned prior to the issuances plus the 250

shares it is treated as acquiring in the cash issuance. A separate group comprised of the former creditors of L owns the 500 shares issued for debt. A third public group owns the 250 shares that are not treated as acquired by Public L in the cash issuance.

Example 4. (i) L has 1,000 shares of a single class of common stock outstanding, all of which are owned by a direct public group (Public L). L issues 1,000 shares pursuant to an offer under which 500 shares must be acquired in exchange for debt and the remainder may be acquired for cash. Under the terms of the offer, only persons that acquire stock for debt are eligible to acquire stock for cash. L has no 5-percent shareholders other than direct public groups immediately after the issuance.

(ii) As a condition of acquiring shares for cash, the creditors are required to purchase stock for debt. Therefore, paragraph (j)(3) of this section does not apply to any part of the issuance because it is not an issuance of stock solely for cash. The segregation rules of §1.382–2T(j)(2)(iii)(B) apply to treat all 1,000 shares as acquired by a new public group separate from Public L.

Example 5. Secondary transfer exception to segregation rules—no new public group. (i) *Facts.* L is owned 60 percent by one public group (Public L_1) and 40 percent by another public group (Public L_2). On July 1, 2014, individual A acquires 10 percent of L's stock over a public stock exchange. On December 31, 2014, A sells all of his L stock over a public stock exchange. No individual or entity acquires as much as five percent of L's stock as a result of A's disposition of his L stock. On January 3, 2015, individual B acquires 10 percent of L's stock over a public stock exchange. On June 30, 2015, B sells all of her L stock over a public stock exchange. No individual or entity acquires as much as five percent of L's stock as a result of B's disposition of her L stock.

(ii) *Analysis.* The dispositions of the L stock by A and B are not transactions that cause the segregation of L's direct public groups that exist immediately before the transaction (Public L_1 and Public L_2). When A and B sell their shares to public shareholders over the public stock exchange, the shares are treated as being reacquired by Public L_1 and Public L_2. As a result, Public L_1's ownership interest is treated as increasing from 54 percent to 60 percent during the testing period, and Public L_2's ownership interest is treated as increasing from 36 percent to 40 percent during the testing period.

Example 6. Secondary transfer exception—first tier entity. (i) *Facts.* L has a single class of common stock outstanding that is owned 60 percent by a direct public group (Public L) and 40 percent by P. P is owned 20 percent by individual A and 80 percent by a direct public group (Public P). On October 6, 2014, A sells 50 percent of his interest in P to B, an individual who is, and remains, a member of Public P.

(ii) *Analysis.* P is an entity that owns five percent or more of L. A is a 5-percent owner of P that is a 5-percent shareholder of L. Because A's sale of the P stock is to a member of Public P, the disposition of the P stock by A is not a transaction that causes the segregation of P's direct public group that exists immediately before the transaction (Public P). See paragraph (j)(13) of this section. When A sells his shares to B, the shares are treated as being acquired by Public P. As a result, Public P's ownership interest in L is treated as increasing from 32 percent to 36 percent during the testing period.

Example 7. Small redemption exception. (i) *Facts.* L is a calendar year taxpayer. On January 1, 2014, L has 1,060 shares of a single class of common stock outstanding, all of which are owned by a single direct public group (Public L). On July 1, 2014, L acquires 60 shares of its stock for cash. On December 31, 2014, in an unrelated redemption, L acquires 90 more shares of its stock for cash. Following each redemption, L's stock is owned entirely by public shareholders. No other changes in the ownership of L's stock occur prior to December 31, 2014.

(ii) *Analysis—(A) July redemption.* The July redemption is a small redemption because the number of shares redeemed (60) does not exceed 106, the small redemption limitation (10 percent of the number of common shares outstanding on January 1, 2014). Under paragraph (j)(14) of this section, the segregation rules of §1.382–2T(j)(2)(iii)(C) do not apply to the July redemption. Under paragraph (j)(14)(iv) of this section, Public L is treated as having all 60 shares redeemed.

(B) December redemption. The December redemption is a small redemption because the number of shares redeemed (90) does not exceed 106, the small redemption limitation (10 percent of the number of common shares outstanding on January 1, 2014). However, under paragraph (j)(14)(i) of this section, only 46 of the 90 shares redeemed are exempted from the segregation rules of §1.382–2T(j)(2)(iii)(C) because the total number of shares of common stock redeemed in the July and December redemptions exceeds 106, the small redemption limitation, by 44. Accordingly, under paragraph (j)(14)(iv) of this section, Public L is treated as having 46 shares redeemed in the December redemption. Section 1.382–2T(j)(2)(iii)(C) applies to the remaining 44 shares redeemed. Accordingly, Public L is segregated into two different public groups immediately before the transaction (and thereafter) so that the redeemed interests (Public RL) are treated as part of a public group that is separate from the ownership interests that are not redeemed (Public CL). Therefore, as a result of the December redemption, Public CL's interest in L increases by 4.4 percentage points

(from 95.6 percent (956/1,000) to 100 percent (910/910)) on the December 31, 2014 testing date. For purposes of determining whether an ownership change occurs on any subsequent testing date having a testing period that includes the December redemption, Public CL is treated as a 5-percent shareholder whose percentage ownership interests in L increased by 4.4 percentage points as a result of such redemption.

Example 8. Segregation rules inapplicable—proportionate amount. (i) *Facts.* P_1 is a corporation that owns 8 percent of the stock of L. The remaining L stock (92 percent) is owned by Public L. P_1 is entirely owned by Public P_1. P_2 is a corporation owned 90 percent by individual A and 10 percent by a public group (Public P_2). On May 22, 2014, P_1 merges into P_2 with the shareholders of P_1 receiving an amount of P_2 stock equal to 25 percent of the value of P_2 immediately after the reorganization. L was owned 92 percent by Public L and 8 percent by P_1 throughout the testing period ending on the date of the merger.

(ii) *Analysis.* Assuming L can establish that P_2 owns 10 percent or less (by value) of L on May 22, 2014 pursuant to the operating rules of paragraph (j)(15)(v) of this section, the segregation rules of §1.382–2T(j)(3)(iii) will not apply to segregate P_1's direct public group (Public P_1) immediately before the merger from P_2's direct public group (Public P_2). Thus, following the merger, P_2 is owned 67.5 percent (90 percent × 75 percent) by A and 32.5 percent (25 percent + (10 percent × 75 percent)) by Public P_2. Pursuant to paragraph (j)(15)(iii)(B) of this section, Public P_2's lowest percentage of ownership is the sum of its lowest percentage of ownership (zero) and a proportionate amount of former Public P_1's lowest ownership percentage of L of 2.6 percent (32.5 percent × 8 percent). P_2 will be treated as having one public group whose ownership interest in L was 2.6 percent before the merger and remains 2.6 percent after the merger. Because Public P_2 owns less than 5 percent of L, Public P_2 is treated as part of Public L. See §1.382–2T(j)(1)(iv). Thus, pursuant to paragraph (j)(15)(iii)(B) of this section, Public L's lowest ownership percentage of L during the testing period is 94.6 percent.

Example 9. Segregation rules inapplicable—prior increase in ownership by former public group during testing period. (i) *Facts.* The facts are the same as *Example 8*, except that P_1 acquired its 8 percent interest in L during the testing period that includes the merger.

(ii) *Analysis.* Pursuant to the rules of paragraph (j)(15)(iii)(A) of this section, the amount of increase in the percentage of stock ownership by Public P_2 is the sum of its increase (zero) and a proportionate amount of the increase by former Public P_1 of 2.6 percent (32.5 percent × 8 percent). Pursuant to paragraph (j)(15)(iii)(B) of this section, Public P_2's lowest percentage of ownership is zero, because both former Public P_1 and Public P_2 owned no L stock at the beginning of the testing period. Accordingly, Public P_2, the continuing public group, is treated as having increased its ownership interest by 2.6 percent. Because Public P_2 is treated as part of Public L, Public L is treated as increasing its ownership interest by 2.6 percent.

Example 10. Ownership limitation based upon fair market value. (i) *Facts.* L has one class of common stock and one class of preferred stock outstanding. The preferred stock is stock within the meaning of §1.382–2(a)(3). Before December 23, 2014, a direct public group (Public L) owns all of the common stock of L. On December 23, 2014, P purchases all of the preferred stock of L and a portion of the common stock of L. On the date of purchase, the value of the L common stock held by P was greater than 5 percent of the value of L, and the total value of L common and L preferred stock held by P was less than 10 percent of the value of all stock of L. P has one class of common stock outstanding, all of which is owned by a direct public group (Public P). On October 7, 2015, P redeems 30 percent of its single outstanding class of common stock. On the redemption date of the P stock, due to a decline in the relative value of the common stock of L, the preferred stock of L owned by P represents 40 percent of the value of all the outstanding stock of L. No ownership change of L occurs between December 23, 2014, and October 7, 2015.

(ii) *Analysis.* The rules of paragraph (j)(15) of this section do not apply to the redemption because P owns more than 10 percent of L (by value) on that date.

Example 11. Ownership limitation—fair market value includes preferred stock. The facts are the same as in *Example 10,* except that the preferred stock is not stock within the meaning of §1.382–2(a)(3). Although the preferred stock is not stock for the purpose of determining owner shifts, the value of that stock is taken into account in computing the 10-percent limitation of paragraph (j)(15)(i) of this section. Therefore, the results are the same as in *Example 10.*

Example 12. Ownership limitation—application of attribution rules. (i) *Facts.* Individual A owns all the outstanding stock of X. A also owns preferred stock in Y that is not stock within the meaning §1.382–2(a)(3), which represents 50 percent of the value of Y. All the Y common stock is owned by public owners. Each of X and Y own 6 percent of the single class of L stock outstanding. On October 6, 2014, Y redeems 15 percent of its common stock.

(ii) *Analysis.* In determining satisfaction of the ownership limitation of paragraph (j)(15)(i) of this section, the attribution rules of section 318(a) apply. Pursuant to section

318(a)(2), A is treated as owning the L stock owned by X. Pursuant to section 318(a)(3), Y is treated as owning the L stock that A indirectly owns. Because Y's ownership of L exceeds the 10 percent ownership limitation of paragraph (j)(15)(i) of this section, the rules of paragraph (j)(15) of this section do not apply.

Example 13. Anti-avoidance rule. (i) *Facts.* P_1 is a corporation that owns 10 percent of the stock of L. P_1 is owned entirely by a direct public group (Public P). L has had owner shifts of 45 percentage points in its current testing period. P_1 is planning to merge into P_2, a corporation which has a public group. Advisers to L, upon learning of the proposed merger, asked the management of P_1 for details of the proposed merger, including the stock ownership of P_2 after P_1 merges into P_2. After finding out that information, L or L's advisers did not request any changes in the planned transaction.

(ii) *Analysis.* The anti-avoidance rule of paragraph (j)(15)(ii) of this section does not apply because L did not participate in planning or structuring the transaction. Pursuant to paragraph (j)(15)(i) of this section, §1.382–2T(j)(3)(iii) does not apply to cause the segregation of P_1's public group from P_2's public group.

(17) *Effective/applicability date.* This paragraph (j) generally applies to issuances or deemed issuances of stock in taxable years beginning on or after November 4, 1992. However, paragraphs (j)(11)(ii) and (j)(13) through (15) of this section and Examples 5 through 13 of paragraph (j)(16) of this section apply to testing dates occurring on or after October 22, 2013. Taxpayers may apply paragraphs (j)(11)(ii) and (j)(13) through (15) of this section and Examples 5 through 13 of paragraph (j)(16) of this section in their entirety to all testing dates that are included in a testing period beginning before and ending on or after October 22, 2013. However, the provisions described in the preceding sentence may not be applied to any date on or before the date of any ownership change that occurred before October 22, 2013 under the regulations in effect before October 22, 2013, and they may not be applied as described in the preceding sentence if such application would result in an ownership change occurring on a date before October 22, 2013 that did not occur under the regulations in effect before October 22, 2013. See §1.382–3(j)(14)(ii) and (iii), as contained in 26 CFR part 1 revised as of April 1, 1994, for the application of paragraph (j)(10) to stock issued on the exercise of certain options exercised on or after November 4, 1992 and for an election to apply paragraphs (j)(1) through (12) retroactively to certain issuances and deemed issuances of stock occurring in taxable years prior to November 4, 1992.

(k) *Special rules for certain regulated investment companies*—(1) *In general.* The segregation rules of §1.382–2T(j)(2) do not apply to the issuance (as described in §1.382–2T(j)(2)(iii)(B)(1)(*ii*)) or the redemption (as described in §1.382–2T(j)(2)(iii)(C)) of any redeemable security, as defined in 15 U.S.C. 80a–2(a)(32), by a regulated investment company in the ordinary course of business.

(2) *Effective date*—(i) *General rule.* Paragraph (k)(1) of this section applies to testing dates after December 31, 1986. A corporation may file an amended return for taxable years ending before August 21, 1992 (subject to any applicable statute of limitations) to take into account paragraph (k)(1) of this section only if corresponding adjustments are made in amended returns for all affected taxable years ending after December 31, 1986 (subject to any applicable statute of limitations).

(ii) *Election to apply prospectively.* A corporation may elect to apply paragraph (k)(1) of this section only to testing dates on or after October 29, 1991. The election must be made on the first return which is filed after October 20, 1992 by stating on such return, ''This is an Election To Apply §1.382–3(k)(1) Only to Testing Dates on or After October 29, 1991.''

[T.D. 8428, 57 FR 38282, Aug. 24, 1992. Redesignated by T.D. 8440, 57 FR 45712, Oct. 5, 1992; 57 FR 52827, Nov. 5, 1992; T.D. 8490, 59 FR 51573, Oct. 4, 1993; T.D. 9638, 78 FR 62423, Oct. 22, 2013]

§1.382–4 Constructive ownership of stock.

(a) *In general.* [Reserved]

(b) *Attribution from corporations, partnerships, estates and trusts.* (1) [Reserved].

(2) *Limitation.* Section 1.382–2T(h)(2)(i)(A) applies solely for purposes of determining whether a loss corporation has an ownership change.

(c) *Attribution to corporations, partnerships, estates and trusts.* [Reserved]